

# STOP THE PRESSES!



## *COUNSEL'S CORNER*

Your erstwhile reporter has found a biggy. At least I think it is. A **BIGGY**. Send me an email and tell me that you do or do not agree.

In 2008 Albert and Jennifer Magill entered into a contract to purchase real estate from The Estate of William H. Watson, Sr. The Magills deposited \$8,000 in earnest money with the title company.

The Magills were unable to renovate / construct due to a truculent Property Owner's Association. So the Magills terminated the deal by sending notice to the Estate. The Magills signed a Release Agreement providing for the return of all Earnest Money to them.

Instead of signing the Release, the Seller (well actually their assignee but no matter for this purpose) sent a notice to the Magills demanding the earnest money. When the Magills did not comply, the Seller filed a lawsuit against them alleging breach of contract.

The lawsuit requested not only the earnest money, but also three times that amount based on a damages provision in the Contract as follows:

D. DAMAGES: Any party who wrongfully fails or refuses to sign a release acceptable to the escrow agent within 7 days of receipt of the request will be liable to the other party for liquidated damages in an amount equal to the sum of: (i) three times the amount of the earnest money; (ii) the earnest money; (iii) reasonable attorney's fees; and (iv) all costs of suit.

The case was tried to a jury, which found the Magills had breached the contract. Judgment was entered for the Seller (again, actually their assignee) for \$32,000, representing the \$8,000 earnest money amount plus liquidated damages of three times the earnest money, as well as attorneys fees, interests and costs.

The Magills appealed, contending that the liquidated damages clause is an unenforceable penalty.

And why is this interesting to us? Because this clause was written by the Texas Real Estate Commission and is presently contained in their on-line forms site, here: <http://www.trec.state.tx.us/pdf/contracts/20-11.pdf>.

But wait there's more. Unless an exception exists, TREC licensees are mandated by law to use that exact form in residential transactions.

They. Have. No. Choice.

And – still more. Some users of commercial real estate contracts and leases in Texas (and outside of Texas too), taking their cue from TREC, have incorporated similar provisions.

The Texas Appellate Court reviewed the clause, and determined that it must be enforced if (1) the harm caused by the breach is incapable or difficult of estimation; and (2) the amount of liquidated damages is a reasonable forecast of just compensation. That follows the ruling given us by the Texas Supreme Court in 1991.

The Appellate Court found authority that if the amount stipulated in the liquidated damages clause is shown to be disproportionate to the actual damages, the clause is a penalty and will not be enforced.

The Court concluded that, because the contract simply takes the value of the earnest money and multiplies it times three, the provision is an unlawful penalty and does not attempt to forecast actual damages.

In fact, the Court used the TREC's own commentary to defeat the TREC's own contract: "This conclusion is supported by the comment promulgated by [TREC] . . . that the purpose of the clause was 'to provide for additional incentives for prompt release of the earnest money.' "

**WOW.** Probably without intending to do so, Al and Jen Magill just gutted TREC's most important contract, and similar provisions contained in commercial contracts and leases too. My surmise is that TREC is busy re-writing the statutorily-mandated sales contracts to comply with this ruling.

The trial court's Judgment was reversed for the Magills; damages were reduced from \$32,000 to \$8,000. See *Magill v. Watson*; No. 01-12-00051-CV, Texas Court of Appeals – First District, July 9, 2013. I am not aware of any further appeals.

Lessons learned:

1. Just because TREC wrote it – or it's contained in a form – doesn't make it enforceable!
2. Liquidated damages clauses are inherently suspect and susceptible to challenge.

3. This might be an opportune moment for you to closely examine your contracts and leases!

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